

INTRODUCTORY SECTION



State of Colorado



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Governor

Jeffrey M. Wells
Executive Director

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November 26, 2003

To the Citizens, Governor, and Legislators of the State of Colorado

It is our privilege to present the Comprehensive Annual Financial Report (CAFR) on the operations of the State of Colorado for the fiscal year ended June 30, 2003. This report is prepared by the Office of the State Controller and is submitted as required by Section 24-30-204 of the Colorado Revised Statutes. The State Controller is responsible for managing the finances and financial affairs of the state and is committed to sound financial management and governmental accountability.

We believe the financial statements are fairly presented in all material aspects. They are presented in a manner designed to set forth the financial position, results of operations, and changes in net assets or fund balances of the major funds and nonmajor funds in the aggregate. All required disclosures have been included to assist the members of the General Assembly, the financial community, and the public in understanding the state's financial affairs.

Except as noted below, the basic financial statements contained in the CAFR are prepared in conformity with generally accepted accounting principles (GAAP) applicable to government as prescribed by the Governmental Accounting Standards Board (GASB), and they are audited by the State Auditor of Colorado. The basic financial statements includes the Management Discussion and Analysis, financial statements, notes to the financial statements, and Required Supplementary Information. The schedules comparing budgeted to actual activity, included in the section titled Required Supplementary Information, are not presented in accordance with GAAP; rather, they reflect budgetary basis of accounting which defers certain payroll and Medicaid expenditures to the following fiscal year. In addition to the basic financial statements the CAFR includes: combining financial statements that present information by fund category; certain narrative information that describes the individual fund categories; supporting schedules; and statistical tables that present financial, economic, and demographic data about the state.

The funds and entities included in the CAFR are those for which the state is financially accountable based on criteria for defining the financial reporting entity as prescribed by GASB. The primary government is the legal entity that comprises the major and nonmajor funds of the state, its departments, agencies, and state funded institutions of higher education. It also includes certain university foundations that have been included with the institution that is financially accountable for the foundation.

The state's elected officials are financially accountable for legally separate entities that qualify as component units. Financial results of the state's component units are discretely presented in the financial statements. The following entities qualify as component units of the state.

University of Colorado Hospital Authority
Colorado Water Resources and Power Development Authority
Denver Metropolitan Major League Baseball Stadium District
CoverColorado

Additional information about these component units and other related entities is presented in Note 2 of the financial statements (see page 67). Audited financial reports are available from each of these entities.

PROFILE OF THE STATE OF COLORADO

Colorado became the thirty-eighth state of the United States of America when it was admitted to the union in 1876. Its borders encompass 104,247 square miles of the high plains and the Rocky Mountains with elevations ranging from 3,350 to 14,431 feet above sea level. The state's major economic sectors include agriculture, manufacturing, technology, tourism, energy production, and mining. Considerable economic activity is generated in support of these sectors by government, wholesale and retail trade, transportation, communications, public utilities, finance, insurance, real estate, and other services. Given the state's semi-arid climate, water resource development, allocation, and conservation are ongoing issues for state management.

The state maintains a separation of powers utilizing three branches of government – executive, legislative, and judicial. The executive branch comprises four major elected officials – Governor, State Treasurer, Attorney General, and Secretary of State. Most departments of the state report directly to the Governor; however, the Departments of Treasury, Law, and State report to their respective elected officials, and the Department of Education reports to the elected State Board of Education. The elected officials serve four-year terms with the number of terms limited in duration.

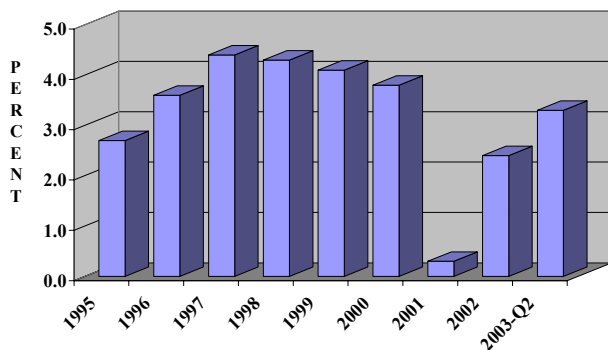
The Legislature is bicameral and comprises thirty-five senators and sixty-five representatives who are also term limited. It is a citizen legislature whose general session lasts 120 days beginning in January of each year. Special sessions may be called by the Governor at his discretion and are limited to the topics identified by the Governor. The Legislature's otherwise plenary power is checked by the requirement for the Governor's signature of its legislation and by specific limitations placed in the State Constitution by voters. The most significant fiscal limitation is the restriction related to issuing debt, raising taxes, and changing existing spending limits. From a fiscal perspective, the Joint Budget Committee of the Legislature, because of its preparation of the annual budget and supplemental appropriations bills, holds the most important power vested in the Legislature. The Committee is bipartisan with members drawn from each of the houses of the Legislature. The Governor's Office of State Planning and Budgeting develops an executive branch budget proposal, but there is no requirement for the Joint Budget Committee to adopt that proposal.

The Judicial Branch is responsible for resolving disputes within the state, including those between the executive and legislative branches of government, and for supervising offenders on probation. The branch includes the Supreme Court, Court of Appeals, and district and county courts, served by 256 justices and judges in 22 judicial districts across the state (excluding 17 Denver county court judges). Municipal courts are not part of the state system. There are also seven water courts, one in each of the major river basins. The Judicial Branch budget is appropriated by the Legislature, and it is funded primarily from general-purpose revenues of the General Fund.

ECONOMIC CONDITION AND OUTLOOK

As in Fiscal Year 2001-02, Fiscal Year 2002-03 opened with a significant reduction in anticipated General Fund revenues. By the time the fiscal year began, the anticipated revenues were \$627.6 million lower than the amount used to formulate the Governor's original budget requests. The decline in anticipated revenues continued throughout the year, and the final estimate of revenues was lower by an additional \$666.6 million. In total, estimated revenues were expected to be down \$1,294.2 million from the estimate upon which the original budget was set. Actual revenues were \$70.8 million above the final estimate, but that amount was small in relation to the overall decline in the revenue estimate. The state's anemic revenues did not parallel the growth in the national economy.

PERCENT CHANGE IN REAL GROSS DOMESTIC PRODUCT



expenditures, which accounted for 1.8 percent of the 3.3 percent, annualized growth. Consumer price inflation remained stable at 1.5 percent, which mitigated fears of imminent deflation, and consumer confidence remained strong.

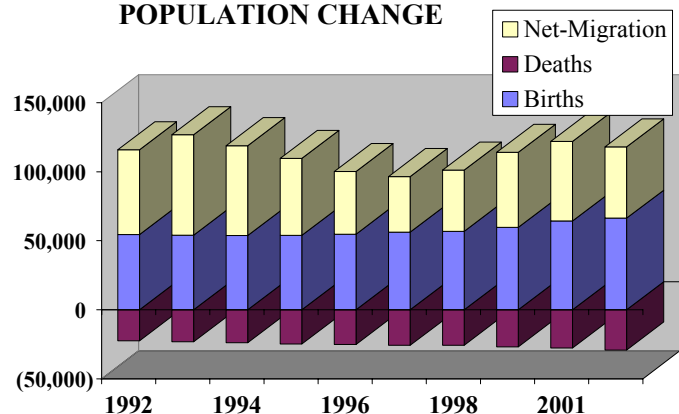
The positive indicators for the national economy are not manifest in the employment statistics. Employment is down nearly two percent from its peak in 2001. Continuing increases in productivity (6.8 percent in the second quarter) have increased corporate profitability, but are likely restricting job creation. With 900,000 jobs lost since December 2001, the continuing decline in employment may prevent the consumer from continuing to drive the economy by increased spending. Unemployment in August 2003 was a moderate 6.1 percent; however, this may not be a valid indicator since jobless workers may have stopped looking for work.

In spite of Colorado's economic difficulties in Fiscal Year 2002-03, net in-migration continued at a high level declining only .15 percentage points from the prior year growth rate of 1.3 percent. The information in the adjacent chart is based on Census Bureau estimates. Data for the year 2000 is not included in the chart because a large adjustment was made to total state population for that year, and matching annual estimates for deaths and births are not available for that year.

In the current economic forecast, the Governor's Office of State Planning and Budgeting (OSPB) notes several positive signs that indicate the worst

Historically, the state lags behind recoveries in the national economy, and the state's delayed participation in the national recovery that began in late 2001 matches that pattern. Gross domestic product grew at an annual rate of 2.4 percent in calendar 2002, and after a weak showing of 1.4 percent in the first quarter increased to 3.3 percent in the second quarter of 2003. The second quarter strength was led by an 8 percent increase in business investment – a positive sign after business investment declines of 5 percent in both 2001 and 2002. Consumer spending growth, primarily driven by durable goods expenditures, buoyed second quarter growth as did Federal government military

COMPONENTS OF COLORADO'S POPULATION CHANGE



of Colorado's economic difficulties may have passed. However, Colorado's economic growth remains dependent on a fragile national recovery. Following is the current OSPB forecast for Colorado's major economic variables:

- ♦ Despite second half improvements, employment will decline .7 percent in 2003, increase to 1.7 percent for 2004, and accelerate to 3.0 percent by 2007.
- ♦ Unemployment will peak at 5.8 percent in 2003 and decline to 4.5 percent by 2008.
- ♦ Wages and salary income will grow by 1.6 percent in 2003, 4.5 percent in 2004, and 6.0 percent by 2006.
- ♦ Total personal income growth will continue to be slow at 1.3 percent in 2003 but increase to 5.0 percent by 2006. Both personal and wage income will be held down by low inflation pressure.
- ♦ In-migration is expected to be slightly over 16,000 or .3 percent in 2003. The net out-migration that accompanied the 1980's recession is not expected to occur due to the dearth of opportunity outside the state.
- ♦ The Denver-Boulder-Greeley inflation rate is forecasted to be 2.1 percent in 2003 and then average 2.5 percent in 2004 and 2005.

MAJOR GOVERNMENT INITIATIVES

As in Fiscal Year 2001-02, during the current fiscal year the establishment of new programs was limited because of the significant shortfall in anticipated revenues. As a result much of the fiscal legislation that was passed was in reaction to existing financial problems rather than establishing new programs. Nonetheless, the following significant changes will affect the state's future fiscal operations.

The Legislature made changes in the governing structure of Colorado's higher education. House Bill 03-1093 established separate boards of trustees for the three colleges formerly governed by the Trustees of the State Colleges in Colorado. The three colleges include Adams State College, Mesa State College, and Western State College.

Due to fiscal problems at the state and at local school districts, the legislature amended the no interest loan program the state operates for school districts. House Bill 03-1274 authorizes the State Treasurer to issue tax and revenue anticipation notes on behalf of the school districts that request a loan to alleviate a cash flow deficit. Any interest or discount on the notes will be paid by the state General Fund. The bill also tightens the requirements for the districts to prove that it will have a cash deficit during the fiscal year and to prove its ability to repay the loan at year end. Senate Bill 03-149 tightened the requirements on school district budgeting and financial reporting by requiring:

- ♦ the budget to ensure adequate reserves,
- ♦ full accrual accounting for school district enterprise funds,
- ♦ a reconciliation between the budgetary basis and modified accrual basis ending fund balance.

House Bill 03-1256 authorized the Department of Corrections to enter a fifteen-year lease purchase agreement limited to \$102.8 million for the construction of a high-custody bed facility. The bill also authorized the state, acting by and through the Regents of the University of Colorado, to enter into a twenty-five year lease-purchase agreement limited to \$202.9 million to finance the construction of academic facilities for the University of Colorado Health Sciences Center at the former Fitzsimons army base. After the close of the fiscal year, an external party filed a lawsuit to prevent the state from entering these lease purchase arrangements.

Senate Bill 03-236 required the Secretary of State to place a referred measure on the November 2003 ballot. The measure asked voters to approve that the Colorado Water Conservation Board issue \$2.0 billion of water infrastructure revenue bonds with a maximum repayment cost of \$4.0 billion. The measure was defeated in the November 2003 election.

BUDGETARY AND OTHER CONTROL SYSTEMS

The annual budget of the state for ongoing programs, except for federal and custodial funds, is enacted by the General Assembly. New programs are funded for the first time in the enabling legislation and continued through the Long Appropriations Act in future periods. For the most part, appropriations lapse at the end of the fiscal year unless extenuating circumstances prompt the State Controller to approve an appropriation rollforward. Capital construction appropriations are normally effective for three years.

The state records the budget in its accounting system along with federal awards and custodial funds of the various departments. Revenues and expenses/expenditures are accounted for on the basis used for the fund in which the budget is recorded except for certain budgetary basis exceptions (see Note RSI-1A). Encumbrances are also recorded and result in a reduction of the budgeted spending authority. Encumbrances represent the estimated amount of expenditures that will be incurred when outstanding purchase orders, contracts, or other commitments are fulfilled. Encumbrances in the General Fund are not reported as a reservation of fund balance unless the related appropriations are approved for rollforward to the subsequent fiscal year. Fund balance is reserved for encumbrances that represent legal or contractual obligations in the Capital Projects Fund and the Department of Transportation's portion of the Highway Users Tax Fund.

In developing the state's accounting system, consideration has been given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition. Those controls also assure the reliability of financial records for preparing financial statements and maintaining the accountability for assets.

The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from that control. The evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within this framework. We believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

RISK MANAGEMENT

The state self-insures its agencies, officials, and employees against the risk of loss related to general liability, motor vehicle liability, and workers' compensation. Property claims are not self-insured, as the state has purchased insurance. The state uses the General Fund to account for the risk management function including operations and all current claims or judgments. (see Note 6-G page 74, Note 22 on page 95, Note 26 on page 101). Actuarially determined and other long-term risk management claims are reported only on the government-wide *Statement of Net Assets*. Medical claims for officials and employees are managed through the Group Benefits Plan Fund, a Pension and Employee Benefits Trust Fund. The Regents of the University of Colorado are self-insured for workers' compensation, auto, general, and property liability.

INDEPENDENT AUDIT

The State Auditor performs an audit of the Basic Financial Statements. The opinion of the auditor is on page 16 of this report. Besides auditing the statewide financial statements, the auditor will from time to time audit the financial statements and operations of various departments and institutions within state government.

In 1996, the United States Congress amended the Single Audit Act of 1984. The amended act clarifies the state's and the auditor's responsibility for ensuring that federal moneys are used and accounted for properly. Under the requirements of this act, transactions of major federal programs are tested. The state prepares a Schedule of Expenditures of Federal Awards for inclusion in the State Auditor's Statewide Single Audit Report. The State Auditor issues reports on the schedule, the financial statements, internal controls, and compliance with the requirements of federal assistance programs.

CASH MANAGEMENT

Statutes permit the State Treasurer to invest cash that is not immediately needed to pay obligations of the state. These investments may consist of obligations of the United States, commercial paper of prime quality, repurchase agreements, bank acceptance agreements, and other investment instruments. The State Treasurer also invests funds of the Colorado Water Resources and Power Development Authority, a component unit, and the Great Outdoors Colorado Trust Fund, a related organization. Both are accounted for in the treasurer's agency funds. At June 30, 2003, the State Treasurer held the following investments at fair value:

Investment Type	Amount in Millions
U.S. Government Securities	\$ 1,122.4
Corporate Bonds	1,021.2
Mortgages	568.1
Commercial Paper	547.0
Mutual Funds	425.0
Asset Backed Securities	402.6
Bank Acceptances	24.3
Other	3.9
Total	<u>\$ 4,114.5</u>

Included above is \$1,311.8 million belonging to Pinnacol Assurance, a related organization for which the State Treasurer maintains in an individual Investment Trust Fund. The financial statements of that fund are included in this report.

CERTIFICATE OF ACHIEVEMENT

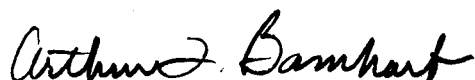
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Colorado for its comprehensive annual financial report for the fiscal year ended June 30, 2002. This was the sixth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

In conclusion, I thank my staff and the staffs of all the state departments and institutions whose time and dedication have made this report possible. I reaffirm our commitment to maintain the highest standards of accountability in financial reporting.

Sincerely,



Arthur L. Barnhart
State Controller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Colorado

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

PRINCIPAL ORGANIZATIONS AND KEY OFFICIALS

